

**DOCUMENT RESUME**

06250 - [B1706738]

H. R. 8588, a Bill To Establish an Office of Inspector General in Various Federal Departments and Agencies. June 15, 1978. 11 pp.

Testimony before the Senate Committee on Governmental Affairs: Efficiency and the District of Columbia Subcommittee; by D. L. Scantlebury, Director, Financial and General Management Studies Div.

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Congressional Relevance: Senate Committee on Governmental Affairs: Efficiency and the District of Columbia Subcommittee.

Authority: Accounting and Auditing Act of 1950. H.R. 8566 (95th Cong.).

The Accounting and Auditing Act of 1950 required GAO to give consideration to the effectiveness of agency internal audit in carrying out its audit responsibilities. Internal auditors nearly always pay their own way many times over by performing audit work that leads to recovery of overpayments from grantees and contractors, adoption of more efficient and economical ways of conducting agency operations, and tightening of controls over cash and other assets to make fraud and abuse more difficult. Currently, auditing includes reviews for compliance with laws and regulations, reviews to determine whether an agency is doing its job effectively and economically, and reviews to determine whether the objective of programs are being met. H.R. 8588 should be modified to clearly indicate that the audit function of each Inspector General should not be subordinated to the investigative function. Shifting extensive resources away from audit work to investigative work is not likely to be beneficial to the Government. In addition, auditors can and do detect fraud and abuse although that is not the primary purpose of their work. The concern is that some Inspectors General will not use auditors to provide balanced audit coverage but rather will narrow the scope of their work to audits designed only to detect fraud and abuse. Suggested modifications to H.R. 8588 involve: the title of Inspector General, the qualifications of the Assistant Inspectors General, definitions of the terms "audit" and "investigation," definition of duties and responsibilities, and submission of semiannual reports. (RBS)

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UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON, D.C. 20548

FOR RELEASE ON DELIVERY  
EXPECTED AT 9:30 a.m.  
THURSDAY, JUNE 15, 1978

STATEMENT OF  
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U.S. GENERAL ACCOUNTING OFFICE

BEFORE THE

SUBCOMMITTEE ON GOVERNMENTAL EFFICIENCY  
AND THE DISTRICT OF COLUMBIA  
COMMITTEE ON GOVERNMENTAL AFFAIRS  
UNITED STATES SENATE  
CONCERNING H.R. 8588, A BILL TO  
ESTABLISH AN OFFICE OF INSPECTOR GENERAL  
IN VARIOUS FEDERAL DEPARTMENTS AND AGENCIES

Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to appear before the Subcommittee to present the views of the General Accounting Office on H.R. 8588, a bill which would establish an Office of Inspector General within various Federal departments and agencies.

With me today are Mr. George L. Egan, Assistant Director, and Mr. John J. Adair, of our Financial and General Management Studies Division.

SUMMARY OF THE TESTIMONY

I want to say at the outset, Mr. Chairman, that GAO strongly supports the basic concepts of H.R. 8588. However, we believe the bill should be modified to clearly indicate that the audit function of each Inspector General should not be subordinated

to the investigative function. In my testimony today, I will discuss GAO's relationship with Federal internal audit, including our efforts to strengthen the Federal audit capability, and our views on the need for balanced oversight of Federal agency programs to provide not only for fraud detection, but for the more traditional areas of audit involvement. I also will make some suggestions for changes in the Inspector General legislation which we believe will make the bill even more beneficial to the government's interests.

#### GAO'S RELATIONSHIP WITH INTERNAL AUDIT

GAO's involvement with Federal internal audit goes back some 28 years, Mr. Chairman, to the Accounting and Auditing Act of 1950. That act requires us to give consideration to the effectiveness of agency internal audit in carrying out our own audit responsibilities. Over the years, we have relied increasingly on the work of internal auditors. In fact, it is standard policy for GAO auditors to obtain relevant reports and working papers prepared by agency internal auditors before we undertake a review in an agency. In many instances this enables us to significantly reduce the scope of our own efforts, saving us both time and resources in the accomplishment of our objectives.

Since we frequently rely on the work of internal auditors, we must, from time-to-time, make comprehensive reviews of each

agency's internal audit system. Within the past 3-years we have issued more than 30 reports to heads of agencies and to the Congress on internal audit operations. In fact, our most recent report was issued on June 6th, to you, Mr. Chairman. I will have more to say about how that report impacts on this legislation in a moment.

In our work, we have found that internal auditors nearly always pay their own way many times over by performing audit work that leads to:

- recovery of overpayments from grantees and contractors,
- adoption of more efficient and economical ways of conducting agency operations, and
- tightening of controls over cash and other assets to make fraud and abuse more difficult.

I do not have complete figures on what internal auditors have saved or recovered for the government over the years, but from the work we have done in examining internal audit, I would estimate that it runs into many billions. These recoveries and savings have occurred even though agencies do not always take full advantage of internal auditors' work.

**BALANCED AUDIT COVERAGE BY  
INSPECTORS GENERAL IS NEEDED**

The 1950 Accounting and Auditing Act also required the Comptroller General to assist Federal agencies in the development of their internal audit capabilities by establishing basic principles and concepts which the agencies could follow. We provided that guidance in the 1950's, Mr. Chairman, and as the scope of

auditing has changed over the years have updated those principles and concepts. In the 1950's, most internal audit coverage was directed almost entirely toward financial reviews. Today, auditing includes reviews for compliance with laws and regulations; reviews to determine whether an agency is doing its job in the most economical and efficient manner; and reviews to determine whether the objectives of the programs authorized by the Congress are being met. We issued "Standards for Audit of Governmental Organizations, Programs, Activities & Functions" in 1972 prescribing this type of audit scope, and supplemented those standards by specific guidance to internal auditors in 1974.

This broader scope of auditing in no way diminishes the need for financial audit coverage, including reviews to detect fraud in Federal programs. GAO is very much aware of the susceptibility of Federal programs to this problem. These programs involve so much money and so many people and institutions that the opportunities for defrauding the government are extensive. Our office will soon be issuing a report on the problem of fraud in the Federal Government, and the actions which we believe are required by agencies to identify fraudulent activity as a basis for establishing the level of resources needed to combat fraud.

In view of the extent of fraudulent activities that have surfaced in recent years, we believe the organizations created by this bill should devote a portion of their audit efforts to detecting fraud. However, to provide maximum benefit to

the government, these organizations must maintain a balance among the types of audits I mentioned earlier--financial, compliance, economy and efficiency, and program effectiveness--in addition to those having fraud detection as the objective. Our reviews have disclosed an already serious lack of financial auditing in the major departments and agencies. In the past 2 years, we have performed 7 reviews to determine the extent of internal financial auditing at the Departments of Labor, Agriculture, Justice, Interior, and Housing and Urban Development and the Veterans Administration and the National Aeronautics and Space Administration. In most of these reviews we found a need for much more financial audit coverage.

Moreover, Mr. Chairman, the report we issued to you on June 6th, stated that 133 governmental units, with annual appropriations in excess of \$20 billion, told us they had not received a financial audit during fiscal years 1974 through 1976--a poor record at best. As I will explain more fully later, this financial audit coverage is as essential to the control of fraud and abuse as investigatory work.

#### ROLE OF AUDITING IN PREVENTING AND DETECTING FRAUD

You may be wondering, Mr. Chairman, why GAO believes that the Offices of Inspectors General established by this bill will use their auditors extensively for investigative work, and what is wrong with such an approach. In response, I would refer you to the bill itself, with its numerous references to fraud and abuse, and to the Congressional Record of April 18th.,

the date H.R. 8588 was approved by the House of Representatives. During House debate on the bill, Congressman after Congressman rose to praise the bill on the grounds that it would create Offices to detect fraud in the Federal Government. The message the present Inspectors General are getting from the bill and from reading the Congressional Record is that their Offices are to be used primarily to detect fraud and abuse in the Government. We are already receiving indications from Federal auditors around the country that they are being used extensively--in some cases almost exclusively--for that purpose.

There are many, Mr. Chairman, who will favor using most of the audit resources of the Inspector General for investigative work. In our judgment, shifting extensive resources away from audit work to investigative work is not likely to be beneficial to the Government. What will be lost will be the benefits of auditors' suggestions for improving governmental efficiency and economy, recovery of overpayments to contractors and grantees, and identification of ineffective activities and programs.

Further, much will be lost in the control of fraud and abuse itself if financial auditing in Government is diminished below its present minimal levels. We all want to prevent fraud and abuse from happening. One major way of doing this

is to set up a system of checks and balances, what we accountants call internal control, that will make it difficult to defraud or embezzle. The responsibility for maintaining an effective system of internal control is one that must be shared by agency management and the internal auditor. Our "Standards for Audit of Governmental Organizations, Programs, Activities & Functions" state that it is management's responsibility to institute adequate procedures and controls to prevent irregularities and improprieties, and to encourage adherence to adopted policies and prescribed requirements. The role of the internal auditor is to test management's procedures and controls to see whether they are working, and if not, to suggest ways to make them work. The auditor must be alert for situations or transactions that could be indicative of fraud, but management's internal control system must be the first line of defense.

We recognize the deterrent effect that occurs when those with opportunity to commit fraud or abuse see others caught and punished. The likelihood of detection and punishment is a strong deterrent. We believe, however, that a two-fold approach is needed--strong internal controls to make fraud and abuse difficult, and a good investigatory system to provide a strong likelihood that offenders will be caught and punished.

I might also mention that auditors can and do detect fraud and abuse although that is not the primary purpose of their work. When auditors find irregularities that indicate fraud or abuse may exist, it is rather common practice to call in the



investigators to fix the blame and develop a sound legal case against the perpetrator. In fact, the mere presence of a capable internal audit organization in an agency helps to prevent fraudulent activity. The knowledge that auditors will be examining transactions of a program or function in the near future is often enough to deter those who would perpetrate fraud.

Our concern, Mr. Chairman, is that some Inspectors General will not use auditors to provide balanced audit coverage but will narrow the scope of their work to audits designed only to detect fraud and abuse. If this happens, agency management will lose the broad scope of services that qualified internal auditors can provide. We have a number of suggestions for modifying H.R. 8588 to help insure that the audit function is not subordinated to the investigative function in this manner.

#### SUGGESTED MODIFICATIONS TO THE BILL

The first change involves the title, "Inspector General," which we believe should be broadened to "Office of Inspector and Auditor General." The present title suggests the Inspector General has the investigative function, but does not indicate his responsibility for the full scope of audit, including audits to determine financial integrity and compliance with pertinent laws and regulations, audits to identify inefficiencies or wasteful practices and audits to assess effectiveness in achieving program goals. We are concerned that unless the investigative and audit functions are given equal emphasis in the

title, the audit structure of the affected agencies could be weakened. We believe the name change we have suggested would retain the impact of the title, "Inspector General," while indicating that this official is also responsible for audit.

Second, we believe the qualifications of the Assistant Inspector General for Audit, and for Investigation, should be spelled out in the bill as is done for the Inspector General and Deputy Inspector General. These officials will be responsible for the day-to-day operations of the office, and they should possess backgrounds and qualifications appropriate for their positions.

Third, we believe the "Definitions" section of the bill should define the terms "audit" and "investigation", and that the definition of audit should include the full scope of financial and compliance, economy and efficiency, and program effectiveness as set forth in our "Standards For Audit Of Governmental Organizations, Programs, Activities & Functions."

Fourth, the section of the bill entitled "Duties and Responsibilities" should clearly state that one of the duties of the Inspector General is to conduct the full scope of audits, as set forth in the amended "Definitions" section, so there is no mistake as to the intention of the Congress that traditional audit activities are to be conducted, and audit resources are not to be used exclusively for detecting fraud and abuse.

COMMENTS ON CHANGES PROPOSED  
BY SUBCOMMITTEE STAFF

Earlier this week, I received a letter from you, Mr. Chairman, requesting that I comment on language drafted by the Subcommittee staff which you are considering adding to the bill to strengthen and clarify the portions dealing with auditing and accounting.

We have reviewed the proposed changes, and endorse each of them. Two of them--the need to define the terms "audit" and "investigation", and the need to clearly state that the Inspectors General are to conduct the full scope of audits--are virtually identical to what I have proposed today.

We also agree with the change which would add the term "effectiveness" whenever the terms "economy and efficiency" are mentioned in the bill. This helps to make it clear that program effectiveness reviews are to be a responsibility of each Inspector General.

Two of your staff's proposed changes involve the Comptroller General's "Standards for Audit of Governmental Organizations, Programs, Activities & Functions." One would have the Inspectors General comply with these standards in carrying out their responsibilities, and the other would require them to take steps to assure that all work performed by non-Federal auditors is in accordance with the standards. We strongly support these changes. The Comptroller General's Standards are well known to the audit community, and have been recommended

for use by Federal auditors by the Office of Management and Budget in their circulars. Putting these requirement into the law, I would think, would therefore not be objectionable to the Inspectors General because the standards have been followed by most Federal audit organizations for the past several years.

The final proposed change would have Inspectors General submit semiannual reports to the Congress describing the financial audit work they have performed, and their opinion on the adequacy of the financial accounts and records that were audited. In view of the lack of financial auditing disclosed in our June 6th report to you, Mr. Chairman, and in our own previous reviews, we think it a good idea to have such reports submitted. As we interpret it, the opinion rendered by the Inspectors General would be their assessment of the accuracy and condition of the financial accounts and records audited by their Offices during the 6-month period, good or bad. This would help the Congress to get a better composite picture of the condition of the Federal financial system.

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Mr. Chairman, this concludes my prepared statement. My colleagues and I will be pleased to respond to any questions you or other members of the Subcommittee may have.